

**The Criminal Investigation Function Provides
Adequate Guidance to Field Offices for Money
Laundering Investigations**

August 2002

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

August 21, 2002

MEMORANDUM FOR CHIEF, CRIMINAL INVESTIGATION

Pamela J. Gardiner

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Criminal Investigation Function Provides Adequate Guidance to Field Offices for Money Laundering Investigations (Audit # 200110024)

This report presents the results of our review of the Criminal Investigation (CI) Function's Money Laundering Investigations. The overall objective of this review was to evaluate the effectiveness of the CI function's efforts in initiating money laundering investigations.

In summary, our review showed that the CI function established policies and procedures that provided sufficient guidance and oversight to CI field offices for initiating money laundering investigations. We provided CI management with a discussion draft of this report for review and comments. Since there were no recommendations in this report, a formal response was not required. Where appropriate, we made changes to the report based on CI management's suggestions.

Copies of this report are also being sent to the Internal Revenue Service managers who are affected by the report. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs) at (202) 622-8500.

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The Criminal Investigation Function Provides Adequate Guidance to Field Offices for Money Laundering Investigations

Background

The Criminal Investigation (CI) function's mission is to serve the American public by investigating potential violations of the Internal Revenue Code (I.R.C.) and related financial crimes in a manner that fosters confidence in the tax system and compliance with the law. The CI function investigates alleged violations of tax and money laundering statutes to accomplish this mission.

The CI function investigates allegations of money laundering violations in accordance with 18 U.S.C §§ 1956 and 1957, U.S.C. 31, and U.S.C. 26 § 6050I.

18 U.S.C §§ 1956 and 1957 were brought into existence by the Money Laundering Control Act of 1986 (MLCA)¹ and established money laundering as a federal offense.

Information about the major money laundering statutes applicable to the CI function's investigative authority is provided in Appendix IV.

Money laundering can be defined as the process by which criminals disguise financial assets so the assets can be used without detection of the illegal activity that produced them. Through money laundering, the criminal transforms the monetary proceeds derived from criminal activity into funds with an apparently legal source. The CI function considers money laundering to be "tax evasion in progress" because all income – including income derived from illegal activity – is taxable.

As a result of the MLCA, the Secretary of the Treasury, the Attorney General, and the Postmaster General entered into a Memorandum of Understanding (MOU). The MOU represents an agreement as to the investigative authority of the three parties under 18 U.S.C. §§ 1956 and 1957. The memorandum specifically allocates jurisdiction to the Internal Revenue Service (IRS) to investigate violations of 18 U.S.C. §§ 1956 and 1957 where the underlying conduct is subject to investigation under the I.R.C. or the

¹ Pub. L. No. 99-570, subtitle H, Sec. 1351-1367 (1986).

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Bank Secrecy Act (BSA).² Treasury Directive 15-42 delegates this investigatory authority to the Commissioner, and IRS Delegation Order 158 delegates the authority to the IRS CI function.

We conducted this review as part of the Treasury Inspector General for Tax Administration (TIGTA) Office of Audit Annual Audit Plan for Fiscal Year (FY) 2001. Fieldwork was conducted in the CI Headquarters Office in Washington, D.C.; the Offices of the Directors of Field Operations, North Atlantic, Midatlantic, and Pacific Areas in Philadelphia, Baltimore, and Laguna Niguel; and the Philadelphia, Charlotte, and San Diego field offices from July 2001 to July 2002. With the exception of the constraints described below, the audit was conducted in accordance with *Government Auditing Standards*.

Although we eventually gained access to the records we needed to evaluate the CI function's adherence to stated policy on money laundering, we endured a substantial delay in completing this audit while the IRS CI function and the Department of Justice worked out the procedures to ensure that grand jury information was not disclosed. From November 16, 2001 through March 25, 2002, we were precluded from reviewing case initiation documents. While nothing came to our attention that would question the authenticity of the documents we reviewed, this delay impeded the prompt access to and review of essential records.

In the memorandum to the CI function requesting access to money laundering investigations, we asked for the management information system input documents and other pertinent forms and narrative documents related to the initiation of the investigations. For some of the investigations, the only document available for our review was the management information system input document.

² Pub. L. No. 91-508, 84 Stat. 1114 to 1124 (1970) (codified as amended in scattered sections of 12 U.S.C. and 31 U.S.C.). Regulations for the BSA, and other related statutes, are found in 31 C.F.R. 103.11-103.77 (1999).

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National Guidelines, Policies, and Procedures Sufficiently Define the Identification and Selection Process for Initiating Money Laundering Investigations

Because of the protocol developed by the CI function, CI Counsel, and the Executive Office for U.S. Attorneys, we were not always able to review supporting documentation for the input document because of the concern for the disclosure of grand jury material. In those instances, the input document was the best evidence available for the analysis of the initiation of the investigation.

Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

The CI function established policies and procedures that provided sufficient guidance and oversight to CI field offices for initiating money laundering investigations. The CI function supports the National Money Laundering Strategy (NMLS)³ and communicates the policies and procedures to the field.

The CI function's Strategy and Program Plan

In 1998, the IRS Commissioner asked the Honorable William H. Webster to direct an independent review of the CI function and to assess the CI function's effectiveness in accomplishing its mission as the IRS' criminal enforcement arm. In April 1999, Judge Webster submitted *Review of the Internal Revenue Service's Criminal Investigation Division* to the Commissioner. The report states that the CI function's mission, first and foremost, is to investigate violations of the nation's internal revenue laws. It also acknowledges that the CI function should continue to exercise its authority to investigate violations of the money laundering and currency statutes.

To focus its efforts, the CI function developed a compliance strategy to facilitate the identification, development, and investigation of significant cases. The strategy explains CI's role in the overall compliance efforts of the IRS. It is a program strategy comprised of three interdependent

³ Pub. L. No. 105-310 (1998) required the development and implementation of a national money laundering and related financial crimes strategy.

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programs: Legal Source Income Tax Crimes, Illegal Source Financial Crimes, and Narcotics Related Financial Crimes.⁴

In July 2001, the CI function issued the CI Strategy and Program Plan (SPP) for FYs 2002 and 2003. The Strategy reaffirms the function's primary mission of investigating Legal Source Income Tax cases. The SPP further states that the CI function plays a key role in the enforcement of the BSA and related federal money laundering statutes in support of the NMLS. To balance its primary goal of investigating Legal Source Income Tax cases and supporting the NMLS, the CI function concentrates its anti-money laundering efforts on the most significant cases and on cases that affect tax administration. In developing investigations, the CI function defines significance by minimum dollar criteria outlined in the Law Enforcement Manual (LEM).⁵

In response to a previous TIGTA audit report,⁶ the CI function stated that it would issue the Annual Compliance Guidance (ACG) in support of the SPP by October 1 of each fiscal year. The FY 2002 ACG again emphasizes that the CI function will continue to re-focus its investigative resources on legal source and other income tax investigations. This document was communicated to the field offices in a memorandum from the Chief, CI.

⁴ The Legal Source Income Tax Crimes program addresses tax investigations involving taxpayers in legal occupations and industries, where only tax or tax-related violations are investigated by the IRS CI function. The objective of the Illegal Source Financial Crimes program is to identify, investigate, and assist in prosecuting the most significant illegal source tax violations, currency, and money laundering offenders and in tracing their assets domestically and internationally for forfeiture purposes. The Narcotics Related Financial Crimes program addresses tax investigations of unreported drug proceeds involving a wide range of professionals and occupations.

⁵ The LEM contains material that is classified as "Official Use Only."

⁶ *Review of the Effectiveness of Criminal Investigation's Strategic Planning Process* (Reference Number 2001-10-098, dated June 2001).

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According to the ACG, the CI function's top priorities for FY 2002, in order of priority, are:

1. Legal and Illegal Source tax investigations.
2. Fraud referrals.
3. Joint Terrorism Task Forces.
4. Narcotics.
5. Money laundering.

In the aftermath of the terrorist attacks of September 2001, federal law enforcement agencies were mobilized to fight terrorism. Through March 2002, the CI function had contributed 9.38 percent of its direct investigative time toward Joint Terrorism Task Forces, Treasury's Operation Greenquest, and other counter-terrorism related activities and financial investigations.

Based on our discussions with CI function field managers, the CI Headquarters Office has communicated the CI strategy to increase Legal Source Income Tax cases, with emphasis on initiating significant cases as defined by the LEM criteria. Guidelines, policies, and procedures are communicated to the field in the context of this strategy.

The National Money Laundering Strategy

The Money Laundering and Related Financial Crimes Strategy Act of 1998⁷ called for the development of a multi-year anti-money laundering strategy. *The 2001 National Money Laundering Strategy* – issued in September 2001 by the Office of Enforcement, Department of the Treasury, in consultation with the Department of Justice – emphasizes the importance of federal, state, local, and international coordination. One of the goals of the strategy is to focus law enforcement efforts on the prosecution of major money laundering organizations and systems. Focusing the mission of High Intensity Money

⁷ Pub. L. No. 105-310 (1998).

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Laundering and Related Financial Crime Area (HIFCA)⁸ task forces and enhancing intra-agency and inter-agency coordination of money laundering investigations through the coordination and consolidation of Suspicious Activity Report⁹ Review Teams (SAR-RT) are two objectives for meeting this goal.

The CI function plays a key role in the enforcement of the BSA and related federal money laundering statutes in support of the NMLS. Six HIFCA task forces were identified in the 2000 and 2001 NMLS reports. According to a document prepared by the CI function that summarizes money laundering initiatives, the CI function is an active participant in all of the designated HIFCA task forces. For example, the document states that in one HIFCA task force, the IRS CI function was instrumental in determining the direction of the HIFCA task force and in designing the work process. The document further states that another HIFCA task force is considered the model for all HIFCA task forces with the IRS CI function and the United States Customs Service as the major participants. The CI function's November 2001 Business Performance Review report and a CI document outlining the organizational structure of the HIFCA task forces and the status of SAR-RTs states that the CI function received funding to support the 2001 NMLS and has taken the initiative to lease space, purchase computer equipment, and hire intelligence analysts to house, equip, and support the HIFCA task forces.

The November 2001 Business Performance Review report states that the CI function is also using available funds from the 2001 NMLS to staff and equip SAR-RTs in each of the

⁸ The designation of HIFCA is required by the Money Laundering and Related Financial Crimes Strategy Act of 1998 and is intended to concentrate law enforcement efforts at the federal, state, and local level on combating money laundering in high intensity money laundering zones.

⁹ A Suspicious Activity Report is filed by financial institutions on transactions or attempted transactions involving at least \$5,000 that the financial institution knows, suspects, or has reason to suspect was derived from illegal activity.

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35 CI field offices. In August 2001, the CI function issued Standard Operating Procedures (SOPs) for the creation and operation of SAR-RTs. The primary objective of the SAR-RTs is the identification and development of sophisticated legal and illegal source financial investigations. This initiative will support the NMLS goal to focus law enforcement efforts on the prosecution of major money laundering organizations and systems. The SOPs adequately outline the process for implementing the teams and ensuring their consistent operation.

Oversight

The Business Performance Review System (BPRS) is an IRS process by which each business unit or function identifies, defines, and tracks the essential elements of its performance. The CI function is required to participate in quarterly BPR meetings. As part of the process, the CI function prepares BPR briefing reports. One of the CI function's operational priorities for FYs 2002 and 2003 is to increase its support of the NMLS. A review of the BPR reports for FY 2002 shows that the CI function includes issues relating to its support of the NMLS in the reports. For example, the November 2001 BPR report discusses the CI function's support of HIFCA task forces and SAR-RTs.

Review and Program Evaluation (R&PE) is the CI function's method for reviewing all aspects of its operations in the field to ensure alignment with the national compliance strategy and compliance with Internal Revenue Manual standards. R&PE conducts a review of each field office every 3 years and addresses major CI function programs. Results of the R&PE reviews are communicated to the Special Agent in Charge of the field office through a formal closeout meeting. Directors of Field Operations are responsible for following up on R&PE reviews 6 months after the completion of the review.

As of September 2001, R&PE had completed reviews of three field offices since the reorganization of the CI function in July 2000. R&PE is providing adequate oversight to the field offices regarding money laundering investigations. The reviews address the major programs and money laundering investigations within these programs. As part of

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the review of a field office's business results, R&PE evaluates adherence to LEM criteria for initiating money laundering investigations. The CI function's procedures require the preparation of a local compliance priority memorandum (LCM) to explain the circumstances that warrant the initiation of an investigation that does not meet LEM criteria. In all three reports, R&PE identified investigations that did not meet criteria, determined whether memoranda were written, and evaluated the memoranda. In one report, R&PE identified a situation in which a memorandum was not prepared. R&PE explained that the guidelines require the preparation of a memorandum to give management an opportunity to ensure the effective use of resources.

Initiation of money laundering investigations

We reviewed initiation documents for 141 subject criminal investigations (SCIs) initiated by the Philadelphia, Charlotte, and San Diego field offices for FY 2000 through June 2001. An SCI is an investigation of an individual or entity alleged to be in noncompliance with the laws enforced by the IRS and having prosecution potential. We evaluated initiations for the principal violation under investigation.

In initiating investigations, the CI function follows minimum dollar criteria outlined in the LEM. The LEM defines the criteria for specific sections of 18 U.S.C. § 1956 and all of 18 U.S.C. § 1957. However, there are no defined minimum dollar criteria for some sections of 18 U.S.C. § 1956 and 31 U.S.C., such as 18 U.S.C. § 1956(h) (money laundering conspiracy) and 31 U.S.C. § 5324 (structuring).¹⁰ In those instances, we evaluated the characteristics of those

¹⁰ Money laundering conspiracy involves an agreement to commit violations of 18 U.S.C. § 1956 or 18 U.S.C. § 1957. A person structures a transaction if that person, acting alone, or in conjunction with, or on behalf of, other persons, conducted or attempts to conduct one or more transactions in currency, in any amount, at 1 or more financial institutions, on 1 or more days, in any manner, for the purposes of evading reporting requirements of the BSA.

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cases against the LEM criteria for comparable sub-sections of applicable statutes with similar money laundering characteristics.

In 46 of the 141 SCIs, the principal violation under investigation was a tax, tax conspiracy, tax and structuring conspiracy, or miscellaneous Title 18 violation. The remaining 95 SCIs had a money laundering, money laundering conspiracy, or structuring violation as the principal violation under investigation.

Overall, we believe the initiation of the 95 SCIs was appropriate. In all but five cases, these SCIs either met the LEM criteria established by CI; had LCMs prepared when the SCI did not meet LEM criteria; or would have met the LEM criteria for comparable sub-sections of the applicable statutes, based on similar money laundering characteristics.

In the remaining five cases, the SCIs did not individually meet specific or comparable LEM criteria or have LCMs prepared. However, three of the five cases were part of a larger indictment that collectively met the criteria. In another case, the individual was allegedly laundering money for the subject of an investigation that met the criteria. In the remaining case, the Assistant United States Attorney requested the CI function's assistance in evaluating the subject's structuring of laundered proceeds from another individual. Based on these related circumstances, we believe the initiation of these five cases was appropriate, even though specific or comparable LEM criteria were not met and LCMs were not prepared.

Coordination Efforts With Other Law Enforcement Agencies and Within the Internal Revenue Service Regarding the Initiation of Money Laundering Investigations Are Adequate

The CI function issued policies and procedures that provided adequate guidance to CI field offices for coordinating money laundering investigations. The agreements between the CI function and external and internal stakeholders are adequate.

The 2001 NMLS emphasizes the importance of interagency coordination. As previously discussed, the CI function supports the NMLS goal of enhanced coordination through its participation in HIFCA task forces and SAR-RTs. A document prepared by the CI function states that the CI function has taken the lead in implementing the HIFCA task

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forces and SAR-RTs and has made the following contributions in support of the strategy:

- Purchased computer equipment to quickly initiate the HIFCA task forces and SAR-RTs.
- Hired an intelligence analyst for each designated HIFCA.
- Ensured that a SAR-RT is operational in each of the 35 CI field offices.
- Established SAR-RT SOPs.
- Provided training on the program that will be used to capture Suspicious Activity Report (SAR) use.
- Selected a Supervisory Special Agent for five of the six HIFCA task forces.
- Selected a cadre of special agents to be assigned to each HIFCA task force.
- Reinforced the CI function money laundering expert witness cadre.

Interviews with officials from the Department of Justice, the Drug Enforcement Administration, and the Department of the Treasury verified that the IRS CI function is a major contributor to interagency money laundering investigations because of the financial expertise of its special agents. The IRS CI function's participation in multi-agency money laundering investigations is considered critical to the investigations.

Agreements

Two major documents guide the CI function in its coordination efforts within the IRS and with other law enforcement agencies:

1. The MOU among the Secretary of the Treasury, the Attorney General, and the Postmaster General regarding Money Laundering Investigations (August 1990).
2. A memorandum entitled "Disclosure of Suspicious Activity Report Information from Financial Institutions to IRS Civil Divisions" (June 2001).

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The MOU among the Secretary of the Treasury, the Attorney General, and the Postmaster General was previously discussed. The MOU and related documents delegate authority to the IRS CI function to investigate violations of 18 U.S.C. §§ 1956 and 1957 where the underlying conduct is subject to investigation under the I.R.C. or the BSA.

The memorandum entitled “Disclosure of Suspicious Activity Report Information from Financial Institutions to IRS Civil Divisions” provides guidance to the CI function for disclosing information to IRS civil operating divisions. Prior to the issuance of this memorandum in June 2001, the CI function had been prohibited from sharing information from SARs with IRS civil divisions for tax compliance purposes. This was the result of an April 1996 agreement between the Financial Crimes Enforcement Network (FinCEN)¹¹ and the banking regulators to restrict access to SAR information because of privacy rights concerns expressed by banking regulators.

In 2001, the CI function held discussions with the FinCEN and banking regulators. The discussions resulted in an agreement to allow the CI function to share information from the SARs that appear to have civil tax potential with IRS civil divisions. The memorandum adequately outlines the process for sharing SAR information with IRS civil divisions.

¹¹ The FinCEN was established by the Department of the Treasury to provide a government-wide, multi-source intelligence and analytical network to support the detection, investigation, and prosecution of domestic and international money laundering and other financial crimes.

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate the effectiveness of the Criminal Investigation (CI) function's efforts in initiating money laundering investigations. We addressed the overall objective through the following sub-objectives:

- I. Evaluated the CI function's case identification and selection process for initiating money laundering investigations.
 - A. Reviewed national guidelines, policies, and procedures and evaluated the CI function's methodology for prioritizing efforts in money laundering enforcement.
 - B. Interviewed key CI function Headquarters management personnel responsible for the development and implementation of the guidelines, policies, and procedures for initiating money laundering investigations.
 - C. Interviewed key CI Field Office management personnel responsible for the implementation of the guidelines, policies, and procedures for initiating money laundering investigations.
 - D. Analyzed the Criminal Investigation Management Information System (CIMIS) data for Fiscal Years (FY) 1998 through April 2001 (see Methodology for details).
- II. Assessed the CI function's coordination efforts within the Internal Revenue Service (IRS) and with other law enforcement agencies regarding money laundering investigations.
 - A. Reviewed national guidelines, policies, and procedures for coordinating with IRS Divisions and other law enforcement agencies regarding money laundering investigations. The national guidelines included laws, inter-agency agreements, and IRS CI function documents.
 - B. Interviewed key CI function Headquarters personnel and internal and external stakeholders involved in liaison activities within the IRS and with other law enforcement agencies.
 - C. Reviewed agreements made between the CI function and internal and external stakeholders.
 - D. Reviewed the CI function's participation in task forces.

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Methodology

The CI function provided us with summary statistical information and detailed data from the CIMIS. We performed the following analyses:

- I. Analyzed summary statistical information for FYs 1998 through April 2001. The information included statistics for the nation and each field office by program and type of violation.
 - A. Calculated the percentage of total subject criminal investigations (SCI)¹ initiated for the nation and for each field office with the following four violation types:
 1. Non-narcotics pure money laundering.
 2. Non-narcotics mixed tax and money laundering.
 3. Narcotics pure money laundering.
 4. Narcotics mixed tax and money laundering.
 - B. Used FY 2001 non-narcotics pure money laundering statistics as a baseline and identified seven field offices for potential further review. The field offices were selected because they were equal to or significantly above or below the national percent of non-narcotics pure money laundering SCIs initiated compared to the total SCIs initiated.
- II. Selected three of the seven field offices for our audit test of initiation documents.
- III. Analyzed detailed data for FYs 2000 and 2001 (through June 2001). The data were an extract from the CIMIS. The CI function did not provide us with all fields because of grand jury issues.
 - A. For the 3 field offices selected, extracted all 213 SCIs initiated for the Illegal Source Financial Crimes Program for FYs 2000 and 2001. We could not specifically identify only the SCIs with pure money laundering violations because the CI function did not provide us with all the necessary fields to conduct this analysis. Selection of all Illegal Source Financial Crimes Program SCIs was adequate because the majority of SCIs with a pure money laundering violation are classified as Illegal Source Financial Crimes SCIs.
 - B. Requested all documents pertinent to the initiation of the 213 SCIs. We communicated our request to the CI function via a memorandum in November 2001. The memorandum included the investigation numbers of the SCIs we selected for each field office. The CI function queried the CIMIS and advised us that 151 of the 213 SCIs had a pure money laundering violation.

¹ An SCI is an investigation of an individual or entity alleged to be in noncompliance with the laws enforced by the IRS and having prosecution potential.

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- C. Reviewed initiation documents for 141 of the 151 SCIs. One of the remaining 10 investigations was actually a duplicate of another investigation, and we reviewed the documents for the related investigation. The Special Agent in Charge advised us that the Criminal Chief, United States Attorney's Office, determined that the remaining nine investigations were extremely sensitive and requested that the CI function not provide initiation documents to us. We believe that our overall results were not adversely affected by this decision.

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Appendix III

Report Distribution List

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Money Laundering Statutes

The Criminal Investigation (CI) function investigates allegations of money laundering violations pursuant to 18 U.S.C. §§ 1956 and 1957, 31 U.S.C., and 26 U.S.C. § 6050I.

- The Money Laundering Control Act of 1986¹ resulted in 18 U.S.C. §§ 1956 and 1957.
 1. In general, 18 U.S.C. § 1956(a)(1) prohibits knowingly engaging in financial transactions using funds derived from a specified unlawful activity with any of four specific intents in mind.
 2. 18 U.S.C. § 1956(a)(2) prohibits anyone to transport, transmit or transfer, or attempt to transport, transmit, or transfer a monetary instrument or funds in or out of the United States, with the intent to promote the carrying on of a specified unlawful activity or knowing that the monetary instrument or funds involved in the transportation, transmission, or transfer represent the proceeds of some form of unlawful activity.
 3. 18 U.S.C. § 1956(a)(3) contains a sting provision whereby the government, or a directed informant, can represent funds as having been derived from a specified unlawful activity.
 4. 18 U.S.C. § 1957 prohibits a monetary transaction of over \$10,000 or an aggregate of monetary transactions of over \$10,000 of criminally derived funds obtained from a specified unlawful activity while using a financial institution.
 5. 18 U.S.C. § 1956(h) states that any person who conspires to commit any offense defined in 18 U.S.C. § 1956 or 18 U.S.C. § 1957 shall be subject to the same penalties as those prescribed for the offense the commission of which was the object of the conspiracy.
- 31 U.S.C., known as the Bank Secrecy Act,² requires report filing with the government and record keeping by financial institutions or individuals for domestic or foreign transactions involving currency, monetary instruments, and foreign accounts. It also sets forth punishment for the failure to make or the falsification of reports or records.

¹ Pub. L. No. 99-570, subtitle H, Sec. 1351-1367 (1986).

² Pub. L. No. 91-508, 84 Stat. 1114 to 1124 (1970) (codified as amended in scattered sections of 12 U.S.C. and 31 U.S.C.). Regulations for the Bank Secrecy Act, and other related statutes, are found in 31 C.F.R. 103.11-103.77 (1999).

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- 26 U.S.C. § 6050I³ requires any person who is engaged in a trade or business who in the course of trade or business receives more than \$10,000 in cash in 1 transaction or 2 or more related transactions to make a return at such time as the Secretary by regulation prescribes.

³ Added by Pub. L. No. 98-369, div. A, Title I, Sec.146(a), 98 Stat. 685 (1984).